

4-1-2006

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### Recommended Citation

Richard A. Johnson, *Why Harmful Tax Practices Will Continue After Developing Nations Pay: A Critique of the OECD's Initiatives Against Harmful Tax Competition*, 26 B.C. Third World L.J. 351 (2006), <http://lawdigitalcommons.bc.edu/twlj/vol26/iss2/4>

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# WHY HARMFUL TAX PRACTICES WILL CONTINUE AFTER DEVELOPING NATIONS PAY: A CRITIQUE OF THE OECD'S INITIATIVES AGAINST HARMFUL TAX COMPETITION

RICHARD A. JOHNSON\*

OFFSHORE: THE DARK SIDE OF THE GLOBAL ECONOMY. By William Brittain-Catlin. New York: Farrar, Straus, and Giroux 2005.

**Abstract:** Offshore tax havens have recently become the target of international criticism and reform efforts due to their role in eroding foreign tax bases through competitive tax practices. William Brittain-Catlin's book, *Offshore: The Dark Side of the Global Economy*, discusses how offshore tax laws have been exploited and explains measures taken by international groups, such as the Organisation for Economic Co-operation and Development (OECD), to counteract harmful tax competition. This Book Review critiques the efforts of the OECD to mitigate offshore tax havens' contribution to harmful tax competition by expanding on two of Brittain-Catlin's conclusions. In doing so, the Book Review will demonstrate that the OECD's actions have not only caused severe economic harm to numerous developing nation economies, but they have failed to elicit sufficient support to successfully curb harmful tax competition.

## INTRODUCTION

Offshore tax havens and financial centers, many of which are located within small, economically developing island nations,<sup>1</sup> have long

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<sup>1</sup> The term “offshore” tax haven refers to “foreign jurisdictions where the legislative, regulatory, and tax framework is less restrictive compared to an investor’s home-base.” G. Scott Dowling, Comment, *Fatal Broadside: The Demise of Caribbean Offshore Financial Confidentiality Post USA PATRIOT Act*, 17 TRANSNAT’L LAW 259, 263 (2004). An offshore financial center is essentially a tax haven that is “principally involved in the financial services sector and in [foreign portfolio investment].” William B. Barker, *Optimal International Taxation and Tax Competition: Overcoming the Contradictions*, 22 NW. J. INT’L L. & BUS. 161, 177 (2002). Many offshore tax havens are island nations in the Caribbean and Pacific with fewer than 200,000 residents. See *id.* at 177; Vaughn E. James, *Twenty-First Century Pirates of the Caribbean: How the Organization for Economic Cooperation and Development Robbed Fourteen CARICOM*

been recognized for providing highly favorable financial advantages to foreign corporations and individuals.<sup>2</sup> These offshore havens, however, have recently become the center of intense international criticism given their role in eroding foreign tax revenues by offering markedly low tax rates<sup>3</sup> and facilitating domestic tax evasion and money laundering through strict financial secrecy laws.<sup>4</sup> In his book, *Offshore: The Dark Side of the Global Economy*, William Brittain-Catlin provides a detailed explanation of the specific abuses of the tax advantages within one of the world's most used offshore havens, the Cayman Islands.<sup>5</sup> In particular, Brittain-Catlin describes how multinational companies have been lured to incorporate subsidiaries within the Cayman Islands to take advantage of its strict financial secrecy laws

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*Countries of Their Tax and Economic Policy Sovereignty*, 34 U. MIAMI INTER-AM. L. REV. 1, 4 (2002). Given their size, along with several other factors, the majority of these nations are considered "have-not countries that rely on financial services to provide them with much needed employment and tax revenues . . ." Matt Blackman, *Still in the Line of Fire*, GOLDHAVEN INFO. SYS. (1999), <http://www.goldhaven.com/LineofFire.htm> (last visited Feb. 24, 2006).

<sup>2</sup> See MILTON GRUNDY, *GRUNDY'S TAX HAVENS: OFFSHORE BUSINESS CENTRES: A WORLD SURVEY*, at v (6th ed. 1993) (noting that as of 1969, 14 jurisdictions existed where one could form a zero-tax entity). The Cayman Islands inception as an offshore financial center began in the 1960s when its business community took advantage of the Eurodollar market to avoid tight U.S. restrictions on the export of the dollar. WILLIAM BRITTAIN-CATLIN, *OFFSHORE: THE DARK SIDE OF THE GLOBAL ECONOMY* 8 (2005).

<sup>3</sup> In May 1996, the Organisation for Economic Co-operation and Development (OECD) was prompted by financial ministers to counter harmful tax competition and its negative effects on national tax bases. ORG. FOR ECON. CO-OPERATION & DEV., *HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE* 3 (1998) [hereinafter *EMERGING GLOBAL ISSUE*]. In its 1998 report, the OECD indicated that one of the criteria to be considered a tax haven is to have no or nominal tax rates. *Id.* at 23; see also Alexander Townsend, Jr., Comment, *The Global Schoolyard Bully: The Organisation for Economic Co-operation and Development's Coercive Efforts to Control Tax Competition*, 25 *FORDHAM INT'L L.J.* 215, 234 (2001) (noting that the British public interest group Oxfam International estimated the amount of lost revenue by industrialized nations due to tax havens at \$50 billion annually).

<sup>4</sup> See, e.g., Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 *HARV. L. REV.* 1573, 1576 (2000) (explaining how strict banking secrecy laws of tax havens have hindered countries from collecting tax revenue on the foreign-sourced income); Kathleen A. Lacey & Barbara Crutchfield George, *Crackdown on Money Laundering: A Comparative Analysis of the Feasibility and Effectiveness of Domestic and Multilateral Policy Reforms*, 23 *NW. J. INT'L L. & BUS.* 263, 277 (2003) (discussing how offshore havens' financial secrecy laws have facilitated money laundering); Dowling, *supra* note 1, at 271 (explaining how the strict financial confidentiality laws of offshore tax havens are often misused by criminal enterprises to hamper legitimate law enforcement measures).

<sup>5</sup> See generally BRITTAIN-CATLIN, *supra* note 2. Brittain-Catlin notes that by harboring offshore financial centers, the Cayman Islands became the fifth-largest banking center in the world. See *id.* at 8; see also Taylor Morgan Hoffman, *The Future of Offshore Tax Havens*, 2 *CHI. J. INT'L L.* 511, 513 (2001) (indicating that only New York, London, Tokyo, and Hong Kong have larger capital markets than the Cayman Islands).

and non-imposition of taxes, effectively allowing these corporations to avoid paying domestic taxes on millions of dollars in annual income.<sup>6</sup> In addition, he illustrates how the Cayman Islands' secrecy laws have allowed corporations to hide debt in various offshore financial instruments to deceive investors with over-inflated financial statements.<sup>7</sup> In doing so, Brittain-Catlin acknowledges how this deceptive practice contributed greatly to the economic collapses of Venezuela, Argentina, Korea, Thailand, Malaysia, and Russia during the 1990s.<sup>8</sup> Furthermore, Brittain-Catlin discusses the use of offshore financial secrecy laws as a medium for criminal activities, which has been a growing concern given the role such hidden money has played in funding international terrorist groups such as Al-Qaeda.<sup>9</sup>

Brittain-Catlin's book also illustrates how numerous countries and international organizations have taken up arms to protect their tax bases from harmful tax competition and their mainlands from illegal activity and terrorist threats through various unilateral and multilateral measures.<sup>10</sup> One notable effort he details was that initiated by the Organisation for Economic Co-operation and Development (OECD), an international advocacy group for economic policy comprised of the world's wealthiest and most politically influential nations.<sup>11</sup> Alarmed

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<sup>6</sup> BRITTAİN-CATLIN, *supra* note 2, at 55, 91–92. By establishing over seven hundred subsidiaries in Caribbean tax havens, Enron paid U.S. corporate federal income tax only once in a five-year period. *Id.* at 55. Despite having profits near \$2 billion, Enron's tax liabilities totaled just \$17 million. *Id.* Similarly, the Stanley Works tool company estimated a reduction from 32% to 24% in domestic taxes, a savings of \$30 million annually, by reincorporating in Bermuda. *Id.* at 91–92.

<sup>7</sup> *See id.* at 72–73 (explaining how Enron used the Cayman Islands' Limited Partnership setup option to hide \$618 million of investment losses offshore, thus allowing it to overstate earnings to investors by \$586 million).

<sup>8</sup> *See id.* at 188. The International Monetary Fund has indicated that various domestic and foreign business ventures within South American and Asian countries similarly hid billions of dollars of losses in offshore financial centers, catalyzing their economic meltdowns. *Id.*

<sup>9</sup> *Id.* at 207–13 (describing the vast global finances of Osama Bin Laden and the difficulty of ascertaining their whereabouts given suspected holdings in onshore and offshore accounts shielded by strict secrecy laws).

<sup>10</sup> *See id.* at 195, 204–06. In 2000, the Financial Action Task Force (FATF) produced a list of fifteen nations without sufficient money laundering controls. *Id.* at 195. The OECD created a similar list in 2000 identifying tax havens engaging in harmful tax practices. *Id.* Brittain-Catlin also describes the European Union savings tax directive, which sought to coerce the Cayman Islands, a dependent territory of Britain, to engage in open exchange of banking information with its other members. *Id.* at 219.

<sup>11</sup> The OECD was established in 1960 for the stated intentions of: 1) achieving sustainable economic growth in member countries, while contributing to the financial stability of the world economy, 2) continually expanding the economies of member countries and to develop those of non-member countries, and 3) contributing to the expansion of world trade

by the international community's loss of revenue due to the prevalent use of offshore tax havens, the OECD has focused its efforts to minimize the effects of "harmful tax competition."<sup>12</sup> Specifically, by employing a blacklisting strategy as well as threats of coordinated sanctions against nations engaging in harmful tax practices, the OECD has sought to coerce many offshore tax havens to incorporate its tax-policy recommendations, which are intended to curtail the use of overly competitive tax and financial secrecy laws.<sup>13</sup>

This Book Review critiques the OECD's measures to curb harmful tax competition by expanding upon two key conclusions reached by Brittain-Catlin. First, he opines that such internationally-coordinated and affirmative actions to mitigate the harms caused by tax havens seriously threaten to dismantle their host-country economies given these nations' dependence on the competitiveness of their financial centers for economic survival.<sup>14</sup> Second, he argues that multilateral policy ef-

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on a multilateral, non-discriminatory basis in accordance with international obligations. See EMERGING GLOBAL ISSUE, *supra* note 3, at 2. Currently, its membership consists of Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. ORG. FOR ECON. CO-OPERATION & DEV., THE OECD'S PROJECT ON HARMFUL TAX PRACTICES: THE 2001 PROGRESS REPORT 2 (2001), available at <http://www.oecd.org/dataoecd/60/28/2664438.pdf> [hereinafter PROGRESS REPORT]. It is a common declaration that "[t]he OECD is a group of the most industrialized and economically powerful nations in the world." Townsend, Jr., *supra* note 3, at 252. This claim is supported by the fact that 19 of the 25 nations boasting the highest world Gross National Products (GNP) in 2003 were OECD members. See Students of the World, Countries of the World: Gross National Product (GNP) Distribution—2003, <http://www.studentsoftheworld.info/infopays/rank/PNB2.html> (last modified Sept. 25, 2004) [hereinafter GNP List]. Not surprisingly, the OECD has been viewed as a "rich nation's club arrogantly rewriting the rules of international competition to protect the interest of politicians from high tax nations." Daniel J. Mitchell, *OECD Wants Tax Havens To Tell All*, WALL ST. J. EUR., Jan. 22, 2001, at 10.

<sup>12</sup> See generally EMERGING GLOBAL ISSUE, *supra* note 3 (providing a discussion of harmful tax practices and a series of recommendations member and non-member nations should adopt to minimize the effects of harmful tax competition). The term "harmful tax competition" refers to attempts by tax haven regimes to offer no or low effective taxation and other benefits for the sole purpose of attracting tax bases from other countries. Hugh J. Ault, *Tax Competition: What (If Anything) to Do About It?*, in INTERNATIONAL AND COMPARATIVE TAXATION: ESSAYS IN HONOUR OF KLAUS VOGEL 1, 3 (2002).

<sup>13</sup> See James, *supra* note 1, at 18–19; Dowling, *supra* note 1, at 278; Townsend, Jr., *supra* note 3, at 215.

<sup>14</sup> See BRITTAİN-CATLIN, *supra* note 2, at 199–225 (detailing several multilateral efforts against tax havens and their specific effect on the Cayman economy). Due to this high dependency on foreign capital, any efforts to punish these tax havens or eliminate the financial advantages they offer "would have a severe impact on government expenditures and long-term growth." Akiko Hishikawa, Note, *The Death of Tax Havens?*, 25 B.C. INT'L & COMP. L. REV. 389, 402 (2002). Similarly, Caribbean and Pacific tax havens believe that the OECD's

forts to minimize the harms of these offshore tax havens, such as the OECD's campaign against harmful tax competition, cannot succeed unless a cohesive interest exists among member nations on the matter.<sup>15</sup>

Using these two themes, this Book Review will illustrate the severity of the economic damage and future fiscal threat posed to the offshore tax havens as a result of the OECD's efforts against harmful tax competition. Furthermore, it will demonstrate how a lack of common interest in tax policy among members as well as the lack of support for the OECD's campaign from key nations places the effectiveness of the OECD's measures in doubt. Part I will provide a brief overview of the OECD's affirmative actions taken to combat the practice of harmful tax competition. Part II will detail the economic threats and current financial devastation experienced by numerous offshore tax havens as a direct result of the OECD's actions. In doing so, this Book Review will first discuss these tax havens' status as developing nations and their resulting reliance on the continued competitiveness of their financial centers for economic survival. Part III will illustrate why the OECD's efforts will be ineffective in combating future harmful tax competition due to a lack of converging interests and support among member nations. In concluding, Part IV will suggest that a multilateral campaign against money laundering would be far more effective and appropriate given the minimal threat such measures pose to these fragile tax haven economies as well as the clear common interest in addressing global terrorism following numerous high-profile terrorist attacks.

## I. THE OECD'S EFFORTS TO MINIMIZE HARMFUL TAX COMPETITION

Since its inception in 1961, the OECD has served as an advocate, forum, and advisor to improve the economies of its member coun-

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campaign will inflict irreversible damage to their developing economies because "the crack-down on tax havens will hinder their efforts to develop new businesses." See Gillian Gunn Clissold, *Can the Windward Islands Survive Globalization?* 20 (Geo. Univ. Caribbean Project, Caribbean Briefing Paper Series No. 4, Mar. 2001) available at <http://www.trinity.edu/academics/depts/interdisc/international/caribbean%20briefings/windward%20islands.pdf> last visited Mar. 8, 2006) (quoting Trinidadian scholar, Anthony T. Bryan). Some even believe the pressure put on these territories by the OECD could return them to "a primitive and backwards agrarian lifestyle." See Everson W. Hull, Professor of Econ., Howard Univ., Remarks Presented to Legislators and Staff at the Capitol Hill Club, *The OECD Imperialists: Implications for the Island of Nevis* (Sept. 29, 2000), [http://www.bahamasb2b.com/b2b/big\\_picture/articles/dr\\_hull.htm](http://www.bahamasb2b.com/b2b/big_picture/articles/dr_hull.htm).

<sup>15</sup> BRITTAIN-CATLIN, *supra* note 2, at 202 ("[T]he multilateral hope of a clear-cut legal solution is only sustainable if it is judged to work in the interests of all states concerned.").

tries, increase global market efficiency, and to facilitate expansion of trade between both industrialized and developing nations.<sup>16</sup> In pursuit of these goals, it has sought to promote internationally favorable legislation among member and non-member nations so as to reach a “unified global economic system.”<sup>17</sup> One of its most recent pursuits began in 1996, when the OECD was prompted by the notable decrease in domestic tax revenues among its member nations to address the rising issue of harmful tax competition.<sup>18</sup> Since then, the OECD has produced various guidelines and aggressive strategies intended to identify and initiate a unified, multilateral offensive against nations engaging in harmful tax practices.<sup>19</sup>

In 1998, the OECD began its campaign by issuing a report listing those competitive tax practices it deemed strong indicators of harmful tax competition.<sup>20</sup> Doing so created a standard that allowed the OECD to later reveal those nations considered to be tax havens.<sup>21</sup> Specifically, the 1998 report held that by imposing no or low effective tax rates, maintaining laws that hinder or prohibit the effective exchange of financial information with other jurisdictions, not requiring investors to engage in substantial investment or transactional activities, and not demonstrating legislative, administrative, or legal transparency concerning issues of foreign investment, a nation would be considered a harmfully competitive tax haven.<sup>22</sup> The 1998 report also promulgated a list of

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<sup>16</sup> Townsend, Jr., *supra* note 3, at 227–28. The Organisation for European Economic Cooperation (OEEC) was established under the Marshall Plan to aid in post World War II reconstruction. *Id.* at 227 n.73. The OEEC was renamed the Organisation for Economic Co-operation and Development (OECD) in 1961 after granting membership to the United States and Canada. *Id.*

<sup>17</sup> *Id.* at 228.

<sup>18</sup> See BRITAIN-CATLIN, *supra* note 2, at 171–72; EMERGING GLOBAL ISSUE, *supra* note 3, at 7. The OECD specifically states that “[g]overnments cannot stand back while their tax bases are eroded through the actions of countries which offer taxpayers ways to exploit tax havens and preferential regimes to reduce the tax that would otherwise be payable to them.” *Id.* at 37.

<sup>19</sup> See EMERGING GLOBAL ISSUE, *supra* note 3, at 21–35 (detailing the harmful tax practices generally employed by tax havens). See generally ORG. FOR ECON. CO-OPERATION & DEV., TOWARDS GLOBAL TAX CO-OPERATION: PROGRESS IN IDENTIFYING AND ELIMINATING HARMFUL TAX PRACTICES (2000) (listing tax haven nations and specific defensive measures countries should take to protect themselves against harmful tax competition) [hereinafter TOWARDS GLOBAL TAX CO-OPERATION].

<sup>20</sup> See EMERGING GLOBAL ISSUE, *supra* note 3, at 23.

<sup>21</sup> See *id.* at 22. Tax havens have also been referred to as “harmful tax regimes,” which have been defined as “preferential, low tax regimes that are primarily tailored to tap into the tax bases of other countries.” Hoffman, *supra* note 5, at 511.

<sup>22</sup> EMERGING GLOBAL ISSUE, *supra* note 3, at 22–25. A nation is non-transparent when it demonstrates an unclear application of laws and administrative rulings that may lead to

policy recommendations to assist offending nations in reforming their practices along with a list of defensive measures that countries could take to protect themselves from the effects of harmful tax competition.<sup>23</sup> Lastly, the OECD avowed to produce a list of regimes they believed to be tax havens according to the factors provided in the report, unless those nations agreed to comply with the 1998 report's guidelines in advance.<sup>24</sup>

The OECD produced that list in its 2000 report entitled *Toward Global Tax Co-operation*, and it identified thirty-five jurisdictions, the vast majority of which were small island nations, as tax havens.<sup>25</sup> The OECD's purpose in producing the list was to stigmatize those nations practicing harmful tax competition in an attempt to discourage investors from engaging in further transactions in these now notorious financial centers.<sup>26</sup> Any country listed as a tax haven would have to

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inequitable treatment of similarly situated taxpayers. *Id.* at 28. The lack of a requirement for investors to engage in significant financial activity suggests that a jurisdiction is attracting investments and transactions that are purely tax-driven. *Id.* at 23.

<sup>23</sup> *Id.* at 40–52. Reformatory policy recommendations for offending nations included the adoption of Controlled Foreign Corporation (CFC) rules that ensure certain CFC income is attributed to and taxed in the hands of its resident shareholder, the implementation of legislation that allowed the reporting of international transactions of foreign operations of foreign taxpayers, and the elimination of double taxation for foreign source income so as to disqualify income benefited by harmful tax practices from an exemption. *See id.* at 40–44. The OECD's suggested defensive measures include adopting more aggressive legislation requiring the exchange of financial information from tax havens as well as the restriction of treaty benefits for entities and income derived from harmful tax regimes. *See id.* at 46–48.

<sup>24</sup> *See id.* at 71; Kimberly Carlson, *When Cows Have Wings: An Analysis of the OECD's Tax Haven Work as It Relates to Globalization, Sovereignty and Privacy*, 35 J. MARSHALL L. REV. 163, 178 (2002).

<sup>25</sup> *See* TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 19, at 17. The OECD's 2000 report listed the following jurisdictions as meeting tax haven criteria as previously outlined in its 1998 Report: Andorra, Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Bahrain, Barbados, Belize, the British Virgin Islands, the Cook Islands, Dominica, Gibraltar, Grenada, Guernsey/Sark/Alderney, the Isle of Man, Jersey, Liberia, Liechtenstein, Maldives, the Marshall Islands, Monaco, Montserrat, Nauru, the Netherlands Antilles, Niue, Panama, Samoa, Seychelles, St. Lucia, St. Christopher & Nevis, St. Vincent & the Grenadines, Tonga, Turks & Caicos, the U.S. Virgin Islands, and Vanuatu. *Id.* Absent from the list are Bermuda, the Cayman Islands, Cyprus, Malta, Mauritius, and San Marino. *See id.*; PROGRESS REPORT, *supra* note 11, at 8. Though these nations met the OECD's tax haven criteria, they made an advance commitment to adhere to the policy recommendations to avoid being named on the list. *See id.*; TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 19, at 16–17.

<sup>26</sup> *See* MICHAEL J. GRAETZ, FOUNDATIONS OF INTERNATIONAL INCOME TAXATION 501 (2003) (implying that the threat of being named on the OECD list was the loss of current banks and investors); James, *supra* note 1, at 33 (“[T]he OECD stated its belief that the blacklisting would have an adverse impact on the economies of jurisdictions thus listed,



commit to either implement the OECD's 1998 recommendations or create an acceptable plan to revise their tax laws to be executed by the end of 2005.<sup>27</sup> In addition, the 2000 report provided a list of sanctions and defensive policy measures that it encouraged all countries affected by harmful tax competition to use in order to minimize the detrimental effects caused by offending tax haven nations.<sup>28</sup> All affected nations were to adopt the OECD's recommended measures in order to pressure tax havens into allowing the free exchange of financial information with foreign tax authorities seeking to subject their residents to domestic taxes.<sup>29</sup> Furthermore, it is argued that the OECD intended the defenses and sanctions as a means to coerce tax haven nations to raise their effective tax rates to harmonize with the much higher ones of the OECD member nations.<sup>30</sup>

The OECD's affirmative actions taken to combat harmful tax competition have left offshore tax havens in a serious dilemma.<sup>31</sup> Either they can comply with the recommendations and relinquish the competitive advantages of their financial industries or they can choose to remain uncooperative and face multilateral sanctions.<sup>32</sup> Regardless of their decision, they are certain to face serious risks of economic backlash.<sup>33</sup>

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essentially because some reputable companies, unwilling to do business in jurisdictions burdened with negative overtones, would relocate their activities to other jurisdictions.”).

<sup>27</sup> See TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 19, at 19 (“The commitment necessary to avoid inclusion on the list of Uncooperative Tax Havens is a public political commitment by a jurisdiction to adopt a schedule of progressive changes to eliminate its harmful tax practices by 31 December 2005.”).

<sup>28</sup> See *id.* at 25. The OECD proffered eleven recommended sanctions and defensive measures to be taken against harmful tax regimes by affected nations. *Id.* Included among these tactics are: 1) denying preferential tax treatment for business transactions with uncooperative tax havens or for transactions seeking to take advantage of the harmful tax practices of the uncooperative tax havens, 2) implementing comprehensive laws that require the open exchange of financial information from transactions involving uncooperative tax havens to be backed by substantial penalties for noncompliance, 3) withholding taxes on payments to residents of uncooperative tax havens, and 4) refusing to enter into any tax agreements with uncooperative tax havens as well as the immediate termination of any existing tax conventions with such tax havens. *Id.*

<sup>29</sup> See *id.* at 24–25.

<sup>30</sup> See Carlson, *supra* note 24, at 176. Carlson argues that the imposition of low or no taxes is a primary factor in determining whether a nation engages in harmful practices. See *id.* Thus, by advocating defensive measures against tax havens, the OECD is effectively deeming their low tax rates inappropriate. See *id.*

<sup>31</sup> See *id.* at 179–80.

<sup>32</sup> See *id.*; see also BRITAIN-CATLIN, *supra* note 2, at 196 (describing how the Cayman Islands had to quickly adopt policy in adherence to multilateral recommendations or face sanctions for non-compliance).

<sup>33</sup> See Carlson, *supra* note 24, at 180; James, *supra* note 1, at 33.

## II. EFFECT OF THE OECD'S MEASURES ON OFFSHORE TAX HAVEN ECONOMIES

It is clear from its 2000 list that OECD efforts to minimize harmful tax competition have focused on small offshore tax haven nations.<sup>34</sup> Yet it is the fact that many of these haven nations generally maintain vulnerable and developing economies that raises questions as to the appropriateness of the OECD's campaign.<sup>35</sup> The reality is that many of these tax haven nations were former European colonies with unstable economies that were rooted in agriculture or other basic industries.<sup>36</sup> Unfortunately, not much has changed with the passage of time as these islands continue to rely heavily upon single-crop agricultural trade and tourism for fiscal preservation.<sup>37</sup> As a result, these nations have generally been unable to catalyze strong, self-sufficient economies due to the high costs of distant trading, volatility of regional climate, a changing global trade market, and frequent complications due to political corruption that significantly affect the agriculture and tourism industries.<sup>38</sup>

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<sup>34</sup> See TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 19, at 17; GNP List, *supra* note 11. Many territories recognized as offshore tax havens are considered "small Caribbean and Pacific island nations" as they generally have populations of fewer than 200,000. See Barker, *supra* note 1, at 177; James, *supra* note 1, at 4. An example of the size differential between the OECD countries and these island tax havens is that seven of the blacklisted islands in the Pacific have a combined GDP of \$1 billion while Australia, an OECD member country, alone has a GDP of \$300 billion. Robert Keith-Reid, *Tax Haven Clampdown!*, PAC. MAG., July 2001, <http://www.pacificislands.cc/pm72001/pmdefault.php?urlarticleid=0019> (last visited Feb. 25, 2006). Also, the total combined population of those seven tax havens is just one-eighth that of Sydney. *Id.*

<sup>35</sup> See TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 19, at 17; GNP List, *supra* note 11. Of the thirty-five jurisdictions listed by the 2000 OECD report, Panama had the highest GNP in 2003, yet was ranked 84th in the world. See TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 19, at 180; GNP List, *supra* note 11. More compelling is that eleven of the countries reporting the lowest twenty-five world GNPs are listed on the OECD's 2000 report as harmful tax havens. See TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 19, at 180; GNP List, *supra* note 11.

<sup>36</sup> See James, *supra* note 1, at 8-9 (discussing how the economies of nations of the current Caribbean Community and Common Market (CARICOM), which include the OECD-recognized tax havens of Antigua, Belize, Dominica, Grenada, St. Lucia, Montserrat, and the Bahamas, among others, were historically dependent upon the production of sugar, coffee, bananas, and citrus); see also BRITAIN-CATLIN, *supra* note 2, at 17 (explaining that in the 1930s, roughly half of the Cayman Islands' manpower was working in the shipping industry).

<sup>37</sup> Hull, *supra* note 14 ("For most of these countries, tourism remains the mainstay of their economies."); Clissold, *supra* note 14, at 2 (noting how Dominica, Grenada, Saint Lucia, and Saint Vincent and the Grenadines "have historically been dependent upon a succession of single crops").

<sup>38</sup> See Clissold, *supra* note 14, at 2 (illustrating how shifts in world trade rendered several Caribbean nations' single crop reliance in bananas uncompetitive); Dowling, *supra*

Consequently, these island havens have continued to experience poverty, high levels of national debt, and stagnant fiscal growth, which has restrained them from becoming financially independent and competitive in the high-tech global economy.<sup>39</sup>

These nations' innovative establishment of competitive offshore financial centers, however, has alleviated many of these financial ills and moved them toward financial independence.<sup>40</sup> Following the implementation of strict financial secrecy laws and levying low or no taxes on foreign investors, more than \$200 billion dollars of foreign direct investment had entered the Caribbean and South Pacific tax haven nations by 1994, a figure ten times greater than that reported in 1985.<sup>41</sup> Other reports suggest that the amount of foreign capital held

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note 1, at 267–68 (noting that poor growing seasons, distant location, high government costs, reliance on external trade, high probability of natural disasters, and limited resources were factors attributed to their dependence on agriculture that once led to unstable economies in these offshore tax haven nations); *ABC Radio Austl., Pacific Island Economies - Can They Make a Go of It?* (2005), <http://www.abc.net.au/ra/pacific/places/jemimiamia.htm> (last visited Feb. 26, 2006) (“Huge distances, poor and expensive transport and lack of business culture all conspire against economic miracles. In some countries, coups, crime and corruption have sapped their nation’s economic vitality.”) [hereinafter *Pacific Island Economies*].

<sup>39</sup> See Anoop Singh, Dir., W. Hemisphere Dep’t Int’l Monetary Fund, Address at the Seminar on Developmental Challenges Facing the Caribbean, *The Caribbean Economies: Adjusting to the Global Economy*, (June 11, 2004), <http://www.imf.org/external/np/speeches/2004/061104a.htm>; *Pacific Island Economies*, *supra* note 38. Because of the region’s low wages for full-time workers, some opine that the resulting poverty within Pacific island nations will make it difficult to sufficiently educate their children to become a force in the information age. *Id.* Continued poverty and unemployment is expected within the Caribbean given that the per capita GDP of the region has increased by less than two percent annually in the past twenty-five years, a growth rate lower than the average of other developing countries. Singh, *supra*. Furthermore, attempts to increase growth through international borrowing have made Caribbean nations “among the most indebted emerging market countries.” *Id.*

<sup>40</sup> See Hull, *supra* note 14 (stating that the offshore banking centers stabilized the economy of Nevis and minimized the fiscal damage that Hurricane Lenny caused to the once highly vulnerable economy); Keith-Reid, *supra* note 34 (noting how the existence of tax haven regimes in the Pacific islands has become a necessary source of jobs, revenue and investment they would not normally have). Hull contends that “the off-shore banking sector helps to generate a measure of self-sufficiency as the country puts the necessary mechanisms in place to declare its full political and economic freedom . . . .” Hull, *supra* note 14.

<sup>41</sup> See, e.g., EMERGING GLOBAL ISSUE, *supra* note 3, at 17; James, *supra* note 1, at 10; Townsend, Jr., *supra* note 3, at 234. “Offshore financial centers attract a wealth of business because they have strict confidentiality rules that appeal to individuals and companies who wish to reduce their tax liability and withhold information from competitors, suppliers, creditors and customers for legitimate reasons.” Dowling, *supra* note 1, at 268. Brittain-Catlin gives an example of such advantages when he notes that in the Cayman Islands, “there has never been income tax, corporation tax, capital gains tax, sales tax, inheritance tax, or death duties.” BRITTAIN-CATLIN, *supra* note 2, at 14. He further describes the pas-

in these island nations is actually around \$8 trillion.<sup>42</sup> More recent statistics indicate that the Cayman Islands alone hold over \$670 billion in banking assets from investors around the globe.<sup>43</sup>

Because of the vast sums of capital entering their shores, the economies of these tax haven nations have become dependent upon the competitiveness of their financial centers to sustain wealth within the private sector, create work opportunities essential to decrease national unemployment rates, and provide sufficient government revenues to finance public health and education expenditures.<sup>44</sup> For example, the financial centers in the small island of Vanuatu provide between \$3 million and \$4 million to the nation's government and 10% of its Gross Domestic Product (GDP), while also creating four hundred jobs in the nation's banking industry.<sup>45</sup> Similarly, it is estimated that 8% to 10% of the GDP of the offshore tax havens in the Pacific are derived from their competitive financial centers, while the Caribbean island of Nevis alone derives more than 30% of its tax revenues from its offshore financial industry.<sup>46</sup> In addition, from 1992 to 1997, the money generated in the Bahamas due to its activities as a tax haven accounted for 15% of its national income and 20% of its government revenues; while financial centers in Barbados reaped 5% of national income and 22% of government proceeds.<sup>47</sup> Public dependence is so elevated that, currently, the government of Barbados derives as much as one third of its revenue through its competitive

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sage of the Confidential Relationships (Preservation) Law that made it "a crime to reveal the details of any financial or banking arrangement made on Cayman." *Id.* at 34. Similar advantages are offered by other offshore nations. *See id.* at 150–51 (discussing how the Bahamas company laws offered "total financial and personal secrecy to shareholders, with no requirement to publish financial accounts"); Hoffman, *supra* note 5, at 514 (illustrating that Bermuda does not tax foreign investors on profits, dividends, or income whether corporate or personal); Offshore Services, Inc., Dominica IBC, <http://dominica-taxhaven.com> (last visited Mar. 8, 2006) (boasting that Dominica provides investors "company incorporation, offshore accounts, online banking and asset protection in total secrecy").

<sup>42</sup> Barker, *supra* note 1, at 177.

<sup>43</sup> Hoffman, *supra* note 5, at 513–14.

<sup>44</sup> *See* Clissold, *supra* note 14, at 20; Hoffman, *supra* note 5, at 513; *cf.* Sir Ronald Michael Sanders, Remarks by the Chief Foreign Affairs Representative with Ministerial Rank of Antigua and Barbuda, The OECD's 'Harmful Tax Competition' Scheme: The Implications for Antigua and Barbuda (Mar. 27, 2001), [http://www.antigua-barbuda.com/business\\_politics/harmful\\_tax\\_competition.asp](http://www.antigua-barbuda.com/business_politics/harmful_tax_competition.asp) (last visited Feb. 25, 2006).

<sup>45</sup> Keith-Reid, *supra* note 34.

<sup>46</sup> Hishikawa, *supra* note 14, at 402; Hull, *supra* note 14.

<sup>47</sup> Hishikawa, *supra* note 14, at 405.

financial institutions.<sup>48</sup> It is even reported that 80% of the Isle of Jersey's income is generated through its financial services industry.<sup>49</sup>

Given this significant fiscal dependence, any loss of competitiveness in the financial services sector resulting from the OECD's actions would have catastrophic results.<sup>50</sup> It is reported that these developing nations could realize as much as a 25% decrease in GDP should they alter their current tax practices to adhere to OECD guidelines.<sup>51</sup> Such striking losses would lead to an economic collapse devastating enough to return these offshore tax havens to their total dependence on highly unstable industries.<sup>52</sup> Consequently, all recent attempts to achieve the economic development, stability, and independence sufficient to control poverty and other social ailments experienced by these nations would be throttled.<sup>53</sup>

Unfortunately, since the advent of the OECD's report on harmful tax competition in 1998, these developing nations have already begun to experience devastating losses to their financial sectors.<sup>54</sup> For example, by adopting legislation to comport with OECD guidelines, Antigua and Barbuda lost fifty-four of the nation's seventy-two banks while the number of businesses incorporated in the territory dropped from 12,378 to 10,797.<sup>55</sup> Such losses resulted in a notable decrease in the employment rate and GDP on the twin-island nation.<sup>56</sup> It is also reported that the nation of St. Vincent and the Grenadines experienced an unemployment rate of 25% to 40% due to the closure of various banks and insurance companies on its islands.<sup>57</sup> Similarly, the pressure from the OECD has forced the Commonwealth of Dominica to shut down one of its banks, while several other banks have fled the island on their own volition to sever association with the nation blacklisted as en-

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<sup>48</sup> James, *supra* note 1, at 33–34; Hoffman, *supra* note 5, at 513.

<sup>49</sup> See Barker, *supra* note 1, at 177.

<sup>50</sup> See Hull, *supra* note 14; Hoffman, *supra* note 5, at 513.

<sup>51</sup> Hull, *supra* note 14; Hoffman, *supra* note 5, at 513.

<sup>52</sup> Hull, *supra* note 14 (“If . . . the OECD is successful in bullying its way, the economies of low-tax countries . . . will be crippled and sent into a tailspin. We will have been returned to a primitive and backwards agrarian lifestyle.”).

<sup>53</sup> See James, *supra* note 1, at 34 (noting how the collapse of the financial sector in Barbados would lead to serious fiscal consequences as well as corruption and crime); cf. Clissold, *supra* note 14, at 20 (discussing the advancements to health, education, and infrastructure in Caribbean nations that have come as a direct result of their thriving financial services sectors).

<sup>54</sup> See James, *supra* note 1, at 38.

<sup>55</sup> See *id.* at 34.

<sup>56</sup> *Id.* at 35.

<sup>57</sup> *Id.* at 38.

gaging in harmful tax competition.<sup>58</sup> Because of the lost revenue, Dominica was forced to alter its national budget to include increased domestic taxes on fuel, sales, cable, and telecommunications services as well as cuts in the size of its government's cabinet.<sup>59</sup>

Even nations that avoided being named on the OECD's 2000 report by granting an advanced commitment to comply with OECD recommendations have experienced similar economic droughts because they have agreed to open financial information exchange and alter taxation policies.<sup>60</sup> For example, since acquiescing to OECD demands, the Cayman Islands have closed several banks, threatened to revoke the charters of companies incorporated within their jurisdiction that had not demonstrated significant domestic transactional activities, and forced its financial services industry not to guarantee absolute financial secrecy to clients.<sup>61</sup> By initiating similar reforms in adherence to the OECD's principles, many offshore havens stand to harm their domestic economies, which have relied on the competitive advantages of their offshore financial industries for economic survival.<sup>62</sup>

Though the above observations demonstrate the seriously detrimental effects the OECD's tactics have had on offshore tax havens' already vulnerable economies, these effects could worsen as the OECD continues to apply pressure on these nations to conform to its tax policy recommendations.<sup>63</sup> The irony, however, is that the elimination of the competitiveness of offshore financial centers and consequent detriment to these developing island nations is not likely to result in the OECD's elimination of harmful tax competition.<sup>64</sup> In fact, it may be within the OECD itself where the biggest hindrance to the effectiveness of its campaign lies.

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<sup>58</sup> See *id.* at 37.

<sup>59</sup> *Id.*

<sup>60</sup> See BRITTAİN-CATLIN, *supra* note 2, at 217.

<sup>61</sup> See *id.*

<sup>62</sup> See James, *supra* note 1, 38; Dowling, *supra* note 1, at 270; Hishikawa, *supra* note 14, at 402.

<sup>63</sup> See Hishikawa, *supra* note 14, at 417 (asserting that because of the threat of impending sanctions and the agreement of offshore tax havens to comply with the OECD's recommendations, "the death of tax havens seems to be inevitable").

<sup>64</sup> See Wolfgang Schön, *Tax Competition in Europe—General Report*, in TAX COMPETITION IN EUROPE I, 16, 17 (Wolfgang Schön ed., 2003) (noting how high-tax OECD countries have taken steps, such as lowering taxes, to compete in the European tax setting).

### III. THE PERSISTENCE OF HARMFUL TAX COMPETITION DESPITE THE OECD'S INITIATIVE

While the OECD's actions work to dismantle offshore tax haven economies, they are unlikely to discontinue harmful tax competition in the future for two major reasons. First, tax policies and preferences among the OECD member countries have proven to be so widely divergent that harmful tax competition does and will continue to exist between the member nations even if the OECD's efforts to eliminate the effects of offshore tax havens succeed.<sup>65</sup> Second, key members have refused their support for the OECD's efforts, which has severely diluted the possibility of maintaining the forceful multilateral campaign needed to deter harmful tax practices.<sup>66</sup> Because of these abstentions and the overall lack of common ground on the issue, the OECD's aggressive efforts will prove ineffective in countering harmful tax competition in the future.

#### A. *The Divergent Interests Among OECD Members Concerning Tax Policy*

Despite the OECD's call for a unified front against harmful tax competition, not all of its member countries are in accord with the campaign, while others continue to engage in tax practices that have the potential to dislocate foreign tax bases.<sup>67</sup> This variance of interest in the attack against harmful tax competition is manifested in the OECD's 2000 report, which acknowledged that a significant number of its member countries continued to harbor "preferential tax regimes" that continue to harbor potentially harmful tax regimes.<sup>68</sup> In fact, though

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<sup>65</sup> See *id.* at 16 (noting how some OECD members have demanded implementation of measures to limit tax rate competition in Europe).

<sup>66</sup> See EMERGING GLOBAL ISSUE, *supra* note 3, at 3, 73–78; Hishikawa, *supra* note 14, at 412–14.

<sup>67</sup> See BRITAIN-CATLIN, *supra* note 2, at 220; Kari S. Tikka, *National Report Finland, in TAX COMPETITION IN EUROPE*, *supra* note 61, at 217, 219.

<sup>68</sup> See TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 19, at 12. The nations mentioned include: Australia, Belgium, Canada, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Korea, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, and the United States. *Id.* at 12–14. A "preferential tax regime" differs from a tax haven according to the OECD's guidelines in that it is a country that collects significant revenues from its domestic income tax, but whose tax system has features constituting harmful tax competition. See EMERGING GLOBAL ISSUE, *supra* note 3, at 20. Furthermore, preferential tax regimes include financial industries such as banking, insurance, or mutual funds that may utilize competitive features, but not features, such as strict financial secrecy, that the OECD focused on in its 1998 report. See TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 19, at 12. Thus, there is not yet a determination as to whether the tax practices are actually harmful. *Id.*

the OECD was internally prompted to combat the ills of harmful tax competition, it reported that twenty-one out of thirty members still maintained financial sectors engaged in potentially harmful tax practices.<sup>69</sup>

Another demonstration of conflicting interests within the OECD concerning tax policy is the wide range of corporate tax rates imposed by its members.<sup>70</sup> Though the average rate of corporate taxation among OECD nations was 31.39%, several member countries have drastically undercut this level with markedly lower rates.<sup>71</sup> For example, Ireland recently imposed an effective tax rate of just 7.6% on foreign-sourced investments from U.S. multinational corporations.<sup>72</sup> Although outside pressures compelled Ireland to raise its overall effective corporate tax rate to 16% in 2002, it emplaced the competitively low rate of 12.5% by 2003.<sup>73</sup> By boasting a below average corporate tax rate of 18%, Hungary also provides unfairly advantageous alternatives to international investors.<sup>74</sup> Yet another OECD country participating in tax competition is the United States, a nation which some consider the world's largest tax haven.<sup>75</sup> In particular, current U.S. tax laws allow multinational corporations to decrease or even eliminate taxes the United States may impose on them.<sup>76</sup> Also, incorporation laws in some U.S. states provide corporate tax advantages similar to the offshore tax havens the OECD has blacklisted.<sup>77</sup>

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<sup>69</sup> See TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 19, at 12–16 (providing list of countries harboring potentially harmful preferential tax regimes); PROGRESS REPORT, *supra* note 11, at 2 (listing the member nations of the OECD).

<sup>70</sup> See Tikka, *supra* note 67, at 219.

<sup>71</sup> See *id.* (noting that European Union (EU) members participate in harmful tax competition). Although the EU is a separate entity from the OECD, eighteen of its twenty-five members are also members of the thirty-country OECD. See EU, The Member States, <http://www.eurunion.org/states/offices.htm> (last visited Mar. 8, 2006).

<sup>72</sup> GRAETZ, *supra* note 26, at 509.

<sup>73</sup> See *id.* (indicating that Ireland's corporate income tax was set at 12.5% in 2003); Robert T. Kudrle & Lorraine Eden, *The Campaign Against Tax Havens: Will It Last? Will It Work?*, 9 STAN. J.L. BUS. & FIN. 37, 51 (2003) (explaining how the fiscal decentralization of the EU allowed for effective campaigns to address Ireland's discriminatory corporate tax rate and Belgium's attempts to attract foreign corporate headquarters); Tikka, *supra* note 67, at 219 (listing Ireland's 16% corporate tax rate as the lowest amongst other OECD members in 2002).

<sup>74</sup> See Tikka, *supra* note 67, at 219.

<sup>75</sup> See GRAETZ, *supra* note 26, at 495.

<sup>76</sup> Karen B. Brown, *Harmful Tax Competition: The OECD View*, 32 GEO. WASH. J. INT'L L. & ECON. 311, 317 (1999).

<sup>77</sup> See BRITTAIN-CATLIN, *supra* note 2, at 79. Specifically, Brittain-Catlin notes how Delaware offers corporations numerous advantages including:



Like the offshore tax havens, these low-tax member countries threaten the tax bases of the high taxing welfare states that steered the OECD's efforts against harmful tax competition.<sup>78</sup> As a result, many prominent welfare state regimes have taken both defensive and offensive measures to minimize the effects of tax competition within the OECD itself.<sup>79</sup> For example, Denmark was forced to lower its corporate tax rates to 30% to compete against its European, OECD peers in generating optimal domestic tax revenue.<sup>80</sup> Similarly, the Netherlands has argued that the low corporate tax rates found in some OECD member nations pose a threat to its domestic tax base.<sup>81</sup> Accordingly, it has demanded that the OECD set a minimum corporate tax rate for member countries to adopt in order to preserve a fixed level of tax revenue.<sup>82</sup>

Yet another area that evidences a lack of cohesion of interests among OECD nations relates to banking secrecy laws, which vary in their degree of rigidness of banking privacy afforded clients.<sup>83</sup> For instance, Switzerland has been long recognized as providing some of the strictest financial secrecy laws in the world.<sup>84</sup> This is explained by the fact that a breach of financial secrecy is deemed an elevated breach of trust under Swiss law, for which a violator is subject to criminal prosecution.<sup>85</sup> Furthermore, there is no exception to this rule when infor-

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inexpensive same-day company incorporation, low fees, minimal financial filing requirements, protection from hostile takeovers, freedom to operate companies anonymously, no required public disclosure of accounts, shareholder secrecy, no sales or inheritance tax, tax advantages for holding companies, and a court system that is seen as having unequaled expertise in complex cases involving multinational companies.

*Id.*

<sup>78</sup> See Schön, *supra* note 64, at 16–18. Many countries within Europe, including Denmark, Sweden and Finland, are welfare states that rely on high taxes to maintain their numerous costly public expenditures. See *id.* at 17–18. Such nations recognize their vulnerability to tax competition, and are thus at the forefront of the fight against tax competition. See *id.* at 17.

<sup>79</sup> See *id.* at 16–18.

<sup>80</sup> See *id.* at 17, 219.

<sup>81</sup> See *id.* at 16.

<sup>82</sup> See *id.*

<sup>83</sup> See generally INTERNATIONAL BANK SECRECY (Dennis Campbell ed., 1992) (illustrating the variance of client protection throughout the world by reviewing international banking secrecy laws).

<sup>84</sup> See Lacey & George, *supra* note 4, at 277 (discussing how Switzerland's banking secrecy laws are famous for providing clients anonymous numbered bank accounts, yet notorious for having aided dictators in hiding corrupt business proceeds).

<sup>85</sup> Hans Bollmann, *Switzerland*, in INTERNATIONAL BANK SECRECY, *supra* note 83, at 661, 669. Violations of Swiss banking secrecy laws are on par with breaches of silence in official matters such that violators are prosecuted at the initiative of the court, whereas violators of

mation is requested by foreign or domestic tax authorities, even in cases of tax evasion.<sup>86</sup> A similarly strict banking law is found in Luxembourg, where even domestic tax authorities are not permitted to seek information from banks concerning their clients' finances unless very limited exceptions apply.<sup>87</sup> Even the United States does not require its banks and other financial institutions to freely exchange financial information of clients with foreign tax agencies.<sup>88</sup>

These stringent prohibitions against information exchange are in stark contrast to the policies of other members of the OECD, which require banks to openly share their clients' financial data with tax authorities.<sup>89</sup> For example, Italian laws have allowed tax agencies to circumvent banking secrecy at will when conducting tax audits.<sup>90</sup> Furthermore, Swedish law requires banks within its jurisdiction to send information annually to tax authorities regarding interest paid to resident clients.<sup>91</sup> Few countries are more cooperative with tax agencies than Sweden, however, whose laws have granted tax authorities such open permission to obtain client information from banks that many question whether any protection of information from tax authorities exists at all.<sup>92</sup> Based on these differences in tax practices among the

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professional secrecy, such as doctors and lawyers, are prosecuted only at the initiative of the injured party. *Id.*

<sup>86</sup> *See id.* at 678. Exceptions to Switzerland's strict financial secrecy apply only to cases of tax fraud, which entail the "deception of the tax authorities by fraudulent means, especially by false or falsified documents which results in an underpayment of tax." *Id.* This high level of secrecy undermines the efforts of the OECD, which recommends that banking laws allow all client information to be shared with any country or tax authority freely and openly. *See* EMERGING GLOBAL ISSUE, *supra* note 3, at 29–30, 46–47.

<sup>87</sup> Guy Harles, *Luxembourg*, in INTERNATIONAL BANK SECRECY, *supra* note 83, at 469, 473. Tax authorities can intrude to garner information for the purposes of assessing inheritance taxes on deceased resident taxpayers. *Id.* Furthermore, in certain circumstances, domestic tax authorities may make inquiries into registration and mortgage duties as well as assessments of the value-added tax. *Id.* Nonetheless, the limited scope of these exceptions ensures the overall insulation of banking secrecy from domestic tax authorities in Luxembourg. *See id.*

<sup>88</sup> Hishikawa, *supra* note 14, at 407.

<sup>89</sup> *See* Olof Wærn & Monica Petersson, *Sweden*, in INTERNATIONAL BANK SECRECY, *supra* note 83, at 647, 651; Cesare Vento & Raffaella Betti Berutto, *Italy*, in INTERNATIONAL BANK SECRECY, *supra* note 83, at 385, 389.

<sup>90</sup> Vento & Berutto, *supra* note 89, at 389. What further separates Italian laws from those countries with strict financial secrecy provisions is that there is no need for tax auditors to establish any criminal suspicion to intercept a client's banking records. *See id.*

<sup>91</sup> Wærn & Petersson, *supra* note 89, at 651. Specifically, Swedish law requires an annual report to tax authorities of: 1) interest accrued on the client's accounts, 2) interest paid by the client, and 3) the balance and transactions on the account for a given period of time. *Id.* at 651–52.

<sup>92</sup> *Id.* at 651.

OECD members, it is clear that harmful tax competition continues to thrive and will continue to do so even if the effects of offshore tax havens are neutralized.<sup>93</sup>

### B. *The Lack of Support by Key Members of the OECD*

Varying interests in tax policy have not only fostered tax competition within the OECD, but they have also caused several key members to abstain from or withdraw their support for measures to combat harmful tax competition.<sup>94</sup> When the OECD's 1998 report was released, both Switzerland and Luxembourg refused to sign the agreement because of their discord with the organization's harsh stance against banking secrecy.<sup>95</sup> Their disapproval of the OECD's aggressive actions has not faltered, as they have continued to withhold their endorsement of the OECD's subsequent reports.<sup>96</sup> Given the historically strict banking secrecy laws in these two countries, their noncompliance seriously undermined the OECD's efforts to have its members agree to adopt legislation to open the exchange of financial information with foreign tax agencies.<sup>97</sup> Yet Switzerland and Luxembourg were not alone, as several other member countries withdrew their support from the OECD's campaign as later reports and recommendations were produced.<sup>98</sup> For example, both Belgium and Portugal rescinded their approval of the OECD's efforts against harmful tax competition following its release of a 2001 update of its goals and progress.<sup>99</sup> Though Belgium and Portugal agreed with some aspects of the OECD's plan, the impetus for their withdrawal was their objection to the more onerous demands made upon some member nations to implement changes in tax legislation.<sup>100</sup>

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<sup>93</sup> See Schön, *supra* note 64, at 16 (noting how EU nations dispute the fairness of tax competition within Europe).

<sup>94</sup> See, e.g., GRAETZ, *supra* note 26, at 511; Hishikawa, *supra* note 14, at 412-13, 414; Townsend, Jr., *supra* note 3, at 235.

<sup>95</sup> See EMERGING GLOBAL ISSUE, *supra* note 3, at 73-78 (providing statements from both Luxembourg and Sweden announcing their decision not to approve the OECD's 1998 report).

<sup>96</sup> See Hishikawa, *supra* note 14, at 414.

<sup>97</sup> See Bollmann, *supra* note 85, at 678; Harles, *supra* note 87, at 472-73.

<sup>98</sup> See, e.g., Schön, *supra* note 64, at 12; Hishikawa, *supra* note 14, at 415 (noting that Belgium, Portugal, and the United States also withdrew their support of the OECD project).

<sup>99</sup> See Schön, *supra* note 64, at 12.

<sup>100</sup> Hishikawa, *supra* note 14, at 414. Belgium and Portugal had already recognized the practice of ring fencing within their borders and had committed to its elimination. *Id.* Ring fencing was identified by the OECD as the practice of by a financial center or regime of partially or fully isolating itself from its domestic economy by either excluding resident

Probably the most devastating blow to the OECD's campaign, however, was the defection of the United States in 2001.<sup>101</sup> Citing its disinterest in global tax harmonization, efforts to coerce foreign nations to adopt specific tax policy, and aggressive policies against tax evasion, the United States decided that the OECD's report was overly broad and inconsistent with the country's tax and economic priorities.<sup>102</sup> Given the country's clout as a global economic leader, many member nations felt that inclusion of the United States in the OECD's efforts was essential to the OECD's success, and thus the organization was forced to amend its project to ensure U.S. involvement.<sup>103</sup> Those revisions diluted the overall aggressiveness of the campaign by relaxing measures against tax evasion, lifting sanctions on tax havens practicing ring fencing, and extending the deadlines by which countries had to commit to cooperate with the OECD's initiatives.<sup>104</sup>

This lack of support by key member nations has had two major repercussions on the OECD's efforts against harmful tax competition. First, such defections have weakened the multilateral leverage of the OECD's efforts, which even the organization itself has admitted is crucial to the overall effectiveness of the project.<sup>105</sup> Second, noncompliance by member countries has given offshore tax havens a strong ar-

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taxpayers from taking advantages of its tax benefits or by harboring enterprises that prohibit operation in the domestic market. EMERGING GLOBAL ISSUE, *supra* note 3, at 26–28. Such measures “effectively protect[] the sponsoring country from the harmful effects of its own incentive regime.” *Id.* at 26.

<sup>101</sup> See BRITAIN-CATLIN, *supra* note 2, at 202–03; Hishikawa, *supra* note 14, at 412–14.

<sup>102</sup> BRITAIN-CATLIN, *supra* note 2, at 203; Terrence R. Chorvat, *A Different Perspective on Tax Competition*, 35 GEO. WASH. INT'L L. REV. 501, 504 (2003); Hishikawa, *supra* note 14, at 412, 413. In describing U.S. reluctance to cooperate with the OECD's efforts, the Secretary of the Treasury at the time, Paul O'Neil, was quoted as saying, “[w]e have no business telling any nation what their tax rates should be.” BRITAIN-CATLIN, *supra* note 2, at 203. He further expressed the country's unwillingness to participate in any initiative to harmonize world taxes. Hishikawa, *supra* note 14, at 412. In subsequent talks with the OECD, the United States also manifested its opposition to the harsh OECD stance against tax evasion. *See id.* at 413.

<sup>103</sup> See BRITAIN-CATLIN, *supra* note 2, at 203 (noting the outrage of France's finance minister over the lack of U.S. support for the OECD project in his statement, “[t]he largest power in the world cannot disengage from the planet's problems”); Hishikawa, *supra* note 14, at 413–14 (noting how the OECD was forced to weaken its stance against harmful tax practices through several modifications in order to retain U.S. backing of the project); GNP List, *supra* note 11 (showing that the United States had the largest GDP in 2003, a figure more than double that of the second place nation, Japan).

<sup>104</sup> See Hishikawa, *supra* note 14, at 413–14.

<sup>105</sup> See EMERGING GLOBAL ISSUE, *supra* note 3, at 38 (“[T]hese multilateral responses are essential because . . . co-ordinated action is the most effective way to respond to the pressures created in the new world of global capital mobility.”).

gument in their opposition of the OECD and its recommendations.<sup>106</sup> Essentially, they have noted the injustice of forcing economically vulnerable island nations to conform to the OECD's recommendations when its own members have refused to do so.<sup>107</sup> Given these serious threats to a unified and widely-supported effort against harmful tax competition, the future effectiveness of the OECD's project is in doubt.<sup>108</sup>

Because its efforts have focused on coercing offshore tax havens to open financial disclosures and engage in less competitive tax practices, the OECD's campaign against harmful tax competition has gravely endangered the fiscal stability of emerging tax haven economies.<sup>109</sup> Doing so without unified cooperation or concerted tax policy interests among its own members seriously calls into question the appropriateness of the OECD's campaign against harmful tax competition. There is, however, another issue concerning offshore tax havens where multilateral efforts may be far more effective and economically equitable—money laundering.<sup>110</sup>

#### IV. MONEY LAUNDERING: A MORE APPROPRIATE MULTILATERAL FOCUS

Offshore tax havens have long been associated with money laundering because their strict financial secrecy laws allow the creation of anonymous accounts while prohibiting the disclosure of financial information to foreign tax authorities.<sup>111</sup> Recent reports indicate that as much as \$600 billion of illegal money is hidden in offshore banks.<sup>112</sup> Furthermore, there is strong evidence indicating that a substantial portion of these funds concealed offshore has been used to sustain terrorist

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<sup>106</sup> See James, *supra* note 1, at 29; Hishikawa, *supra* note 14, at 415.

<sup>107</sup> See James, *supra* note 1, at 29 (discussing how the CARICOM nations complained that they were being forced to comply with the OECD, although Switzerland and Luxembourg refused); Hishikawa, *supra* note 14, at 415 (noting Vanuatu's outrage concerning the OECD's actions against their financial regimes given that Switzerland, Luxembourg, Belgium, and Portugal had refused to adhere to the organization's recommendations).

<sup>108</sup> See Hishikawa, *supra* note 14, at 417.

<sup>109</sup> See Carlson, *supra* note 24, at 180, 181; Hishikawa, *supra* note 14, at 417.

<sup>110</sup> See Lacey & George, *supra* note 4, at 274–75. Money laundering is the “process by which one conceals the existence, illegal source, or illegal application of income and then disguises that income to make it appear legitimate in the open economic market.” *Id.* at 267.

<sup>111</sup> See *id.* at 274–75, 277; Dowling, *supra* note 1, at 271.

<sup>112</sup> Dowling, *supra* note 1, at 271.

groups such as Al-Qaeda.<sup>113</sup> Consequently, many countries and international groups have implemented measures to curb the prevalence of international money laundering, though most efforts have proven ineffective.<sup>114</sup> Nevertheless, there is an indication that a new wide-scale, multilateral effort against money laundering would prove successful, ironically because the barriers that the OECD's campaign against harmful tax competition faces are not present on this particular issue.<sup>115</sup> Specifically, anti-money laundering policies are less invasive to financial secrecy, thus posing only a nominal economic threat to the fragile offshore tax haven economies.<sup>116</sup> In addition, due to the ubiquitous nature of money laundering and recent high-profile terrorist attacks, the current global climate indicates a tremendous convergence of global interests on the matter.<sup>117</sup>

#### A. *The Minimal Economic Threat to Offshore Tax Havens*

There are two major reasons why an immediate multilateral campaign to minimize money laundering may pose less grave threats to offshore economies than the OECD's efforts against harmful tax competi-

<sup>113</sup> See BRITAIN-CATLIN, *supra* note 2, at 207–13 (explaining U.S. concerns that Osama Bin Laden and other terrorist supporters have contributed to Al-Qaeda funds secretly held offshore).

<sup>114</sup> See Lacey & George, *supra* note 4, at 290–345 (providing an overview of various measures that nations and global groups have taken against money laundering). Following the 9/11 attacks, the United States enacted the USA PATRIOT Act, which included the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 (IMLAFA). 31 U.S.C. § 5318A (2001); Lacey & George, *supra* note 4, at 291; The IMLAFA granted the Secretary of the Treasury the authority to require domestic financial institutions to implement increased record-keeping and reporting procedures or face economic sanctions. Dowling, *supra* note 1, at 289–90. A prominent multilateral measure against money laundering was initiated by the FATF, which produced a list of policy recommendations for members and non-members to combat money laundering. Lacey & George, *supra* note 4, at 341–42. Also, the FATF produced a list in 2000 meant to blacklist those nations “whose detrimental practices seriously and unjustifiably hamper the fight against money laundering.” *Id.* at 343. Unfortunately, many initiatives enacted to minimize global money laundering have been unsuccessful, especially those enacted before 2001. *Id.* at 289, 349. The reason for this general ineffectiveness is the “lack of uniformity and cooperation in anti-money laundering legislation across nations.” *Id.* at 349.

<sup>115</sup> See Lacey & George, *supra* note 4, at 349–50 (suggesting that a cohesive multilateral effort against money laundering may currently prove successful if implemented).

<sup>116</sup> See *id.* at 347; Carlson, *supra* note 24, at 183; Dowling, *supra* note 1, at 272.

<sup>117</sup> See BRITAIN-CATLIN, *supra* note 2, at 204–14; Alison S. Bachus, Note, *From Drugs to Terrorism: The Focus Shift in the International Fight Against Money Laundering After September 11, 2001*, 21 ARIZ. J. INT'L & COMP. L. 835, 859 (2004); Dowling, *supra* note 1, at 280, 84–85; Sarah Laitner & George Parker, *UK Urges Clamp Down on Terrorism Funding*, FIN. TIMES (FT.COM), July 12, 2005, <http://news.ft.com/cms/s/920b8fea-f2d8-11d9-8094-00000e2511c8.html> (last visited Mar. 8, 2006).

tion. First, the measures needed to uncover criminal funds, such as the “Know Your Customer” (KYC) rules, may be less intrusive than those of the OECD to report financial information of all foreign investors.<sup>118</sup> Though KYC rules require banks to ascertain information about their clients, they do not necessarily compel the disclosure of that information to other tax agencies or foreign governments unless there is suspicion of criminal transactions.<sup>119</sup> Therefore, by adopting a lenient KYC provision rather than the strict financial openness required by the OECD, offshore tax havens would only risk the flight of criminal money from their financial centers, while legitimate foreign-sourced income would remain protected by banking secrecy laws.<sup>120</sup> Given that the amount of criminal money held offshore is less significant than some have speculated, these KYC rules would allow offshore havens to retain the majority of their foreign-sourced income along with the generous tax revenues, elevated employment rates, and overall private wealth it generates.<sup>121</sup> Thus, unlike the wholly intrusive information exchange required by the OECD, adopting limited KYC provisions would allow tax haven nations the ability to sustain the independent wealth needed to counter the debt and poverty that have plagued them as developing nations.<sup>122</sup>

Second, while adopting the OECD’s recommendations poses serious economic risks to offshore tax havens, offshore tax havens actually stand to gain fiscally by enacting anti-money laundering legislation.<sup>123</sup>

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<sup>118</sup> Compare Lacey & George, *supra* note 4, at 306, 347 (KYC rules require financial institutions to keep records of customer identity, account activity, and source of funds as well as seek further information only on “suspicious” accounts), with EMERGING GLOBAL ISSUE, *supra* note 3, at 46 (stating the OECD’s objective that nations adopt legislation requiring the free exchange of financial information with other countries).

<sup>119</sup> See Lacey & George, *supra* note 4, at 347.

<sup>120</sup> See *id.*

<sup>121</sup> See Carlson, *supra* note 24, at 181 (noting that offshore tax havens risk losing millions of dollars in client investments should they adopt the OECD’s exchange of information recommendations); Dowling, *supra* note 1, at 272 (asserting that the vast majority of foreign investors with offshore bank accounts are legitimate); cf. Sanders, *supra* note 44 (noting how Antigua and Barbuda’s adherence to the OECD’s open exchange provisions would lead to losses of government revenues and expenditures, decreased income from private business ventures and the disappearance of numerous high-paying work opportunities).

<sup>122</sup> See *Pacific Island Economies*, *supra* note 38 (noting the stagnant poverty in the Pacific island nations and the need for economic growth to counteract it); Singh, *supra* note 39 (discussing the high indebtedness of the Caribbean nations and the need for fiscal independence); Hull, *supra* note 14 (arguing that the existence of competitive financial services industries is crucial for the economic self-sufficiency of Caribbean nations).

<sup>123</sup> Bachus, *supra* note 117, at 839–40; see Carlson, *supra* note 24, at 180, 181; Hoffman, *supra* note 5, at 513.

Money laundering has not only sustained organized crime in offshore havens, but the persistence of criminal activity has discouraged legitimate investors from engaging in offshore transactions.<sup>124</sup> Therefore, by establishing measures against money laundering, offshore tax havens can both increase legal commercial development and ensure the entry of legitimate capital into their financial institutions necessary to catalyze their economic stability and independence.<sup>125</sup> Because of the fiscal incentives and the minimal economic risks in espousing modest KYC laws, some offshore havens have already evidenced a clear desire to cooperate in the global fight against money laundering.<sup>126</sup> Though their support is crucial, it is the fact that many nations around the globe also share the same interests that will ensure the success of a multilateral effort to combat international money laundering.<sup>127</sup>

### B. *The Convergence of Global Interests Against Money Laundering*

Money laundering is truly a global issue because, unlike harmful tax competition, it affects the financial institutions of every country.<sup>128</sup> Even the world's most developed countries, including the United Kingdom and the United States, have contributed to the problem.<sup>129</sup> Furthermore, because money laundering is a criminal matter rather than one of tax policy preference, there has been universal recognition of its impropriety as well as accord in the urgency to address it through unified policy.<sup>130</sup> However, it is because of major recent terrorist attacks that international interest have converged to such a point as to ensure

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<sup>124</sup> Bachus, *supra* note 117, at 840; Dowling, *supra* note 1, at 284–85.

<sup>125</sup> See Hull, *supra* note 14 (discussing the importance of the competitive financial centers for the economic independence of offshore tax haven nations); cf. Bachus, *supra* note 117, at 839–40 (implying that the lack of anti-money laundering measures has impeded commercial development and the influx of legitimate investment capital into developing nations).

<sup>126</sup> See Dowling, *supra* note 1, at 284–85 (noting how the threat crime poses to the stability of their needed financial centers has led offshore tax havens to respond positively to international concerns over money laundering).

<sup>127</sup> See Lacey & George, *supra* note 4, at 307, 351; Bachus, *supra* note 117, at 859; Laitner & Parker, *supra* note 117.

<sup>128</sup> Dowling, *supra* note 1, at 280.

<sup>129</sup> BRITAIN-CATLIN, *supra* note 2, at 192 (noting that after the fall of the Russian economy in the 1990s, it was discovered that the Bank of New York was used to launder an estimated \$7.5 billion of illegal money from Russia); Dowling, *supra* note 1, at 285 (stating that terrorists launder “most of their monies through onshore financial center [sic], such as London”); Hoffman, *supra* note 5, at 513 (discussing how offshore tax havens recognize that financial institutions in both New York and London are used for money laundering).

<sup>130</sup> See Bachus, *supra* note 117, at 859; Dowling, *supra* note 1, at 284.



the needed cooperation for an effective multilateral campaign against money laundering.<sup>131</sup>

Following the 9/11 terrorist attacks, the United States immediately enacted laws to aid in uncovering terrorist funds held in its financial centers.<sup>132</sup> Soon after, numerous developed nations and offshore tax havens were prompted by U.S. initiatives and quickly agreed to adopt measures to combat international money laundering and uncover hidden terrorist financing.<sup>133</sup> Since then, fervor for the search of terrorist funds through anti-money laundering legislation has only intensified, especially following the London bombings on July 21, 2005.<sup>134</sup> What is important, however, is that this zeal is not centralized within a few nations of similar culture or disposition; rather numerous countries of varied background have recently experience the first-hand effects of terrorism including Jordan, Spain, the Philippines, and India.<sup>135</sup> Because this internationally convergent interest indicates the elevated potential for effectiveness, now is the opportune time to initiate a unified, multilateral campaign against money laundering.<sup>136</sup>

#### CONCLUSION

The OECD's campaign against harmful tax competition employs economically inappropriate measures that come at an inopportune time. By coercing offshore tax havens to comply with its recommendations through multilateral defense measures and economic sanctions, the OECD has diluted the strict banking secrecy laws of these offshore nations to allow the open disclosure of financial information with foreign governments. This sudden loss of competitiveness has resulted in the fiscal collapse of numerous developing offshore nations, most of which are highly dependent on the revenues from their financial services industries for economic stability and growth. Regrettably, these consequences do not signify the end of harmful tax competition, as many countries within the OECD itself continue to maintain low cor-

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<sup>131</sup> See Bachus, *supra* note 117, at 859; Hishikawa, *supra* note 14, at 414–15; Laitner & Parker, *supra* note 117.

<sup>132</sup> See Dowling, *supra* note 1, at 287, 289. The USA PATRIOT Act was passed just weeks after the 9/11 attacks. *Id.* at 287. This Act contained the IMLAAFA, which gave the government special power to require stricter financial record keeping by domestic banks with aggressive sanctions for noncompliance. *See id.* at 289–90.

<sup>133</sup> See Bachus, *supra* note 117, at 859; Hishikawa, *supra* note 14, at 414–15.

<sup>134</sup> See Laitner & Parker, *supra* note 117.

<sup>135</sup> See Dowling, *supra* note 1, at 280; Wikipedia, *List of Terrorist Incidents*, [http://en.wikipedia.org/wiki/List\\_of\\_terrorist\\_incidents](http://en.wikipedia.org/wiki/List_of_terrorist_incidents) (last visited Mar. 8, 2006).

<sup>136</sup> See Lacey & George, *supra* note 4, at 351.

porate tax rates and strict banking secrecy provisions to attract foreign-sourced income from high-tax countries. Furthermore, the future effectiveness of the OECD's efforts is doubtful given that many key nations, such as the United States and Switzerland, have withdrawn or withheld their support for the organization's aggressive attack against competitive tax practices.

Despite the clear limitations of the OECD's campaign against harmful tax competition, a similar multilateral movement to address international money laundering would prove more successful and fiscally equitable to nations of all economic conditions. The laws necessary to uncover illegal funds, such as moderate KYC laws, prove less invasive than those in the campaign against harmful tax competition, which require unlimited financial information exchange with tax authorities. Therefore, by adopting the less intrusive KYC rules, offshore tax havens risk deterring illegal investments exclusively, while protecting the revenues from legitimate deposits upon which their economic sustainability depends. In addition, these offshore financial centers actually stand to gain from the suppression of money laundering as it would entice a larger volume of legitimate investors, thus stimulating the economic growth necessary to remove these offshore tax havens from "developing nation" status. Most compelling, however, is that such a campaign would prove effective given the common global interest in eradicating the concealment of illegal funds offshore. Specifically, the ubiquity of offenses and the rising interest in uncovering terrorist finances around the world ensures the pervasive support needed for an effective and globally-unified movement against money laundering.

